

The University of Chicago

TAXATION OF INTANGIBLES IN
CHICAGO: ADMINISTRATIVE
SUBSTITUTES FOR STATU-
TORY CHANGE

A PART OF A DISSERTATION SUBMITTED
TO THE FACULTY OF THE DIVISION OF
THE SOCIAL SCIENCES IN CANDIDACY FOR
THE DEGREE OF DOCTOR OF PHILOSOPHY

DEPARTMENT OF ECONOMICS
1936

By
OSCAR L. ALTMAN

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TAXATION OF INTANGIBLES IN CHICAGO: ADMINISTRATIVE SUBSTITUTES FOR STATUTORY CHANGE

Oscar L. Altman*

THE ADMINISTRATIVE regulations adopted in Chicago since the 1931 assessment to govern the taxation of all classes of intangible personal property may be summarized as follows:

(1) A classified property tax has openly replaced the general property tax required by the Constitution¹ and the revenue act² of Illinois.

The general property tax was once widely used in the United States but has not generally been regarded as successful.³ Some states have retained the property tax principle by eliminating the requirement of uniform treatment for all kinds of property; these have grouped property into different classes, and then taxed these classes at different effective tax rates. Other states have abolished or sharply curtailed the tax upon personal property; these have turned to the income tax as a substi-

tute. Only Illinois, in company with eleven other states, retained the general property tax in 1934.⁴ But though Illinois officially⁵ still retains the general property tax, the City of Chicago for all intents and purposes adopted classification during the 1931 assessment. For that assessment intangibles were publicly listed at a smaller percentage of their fair cash value than all other kinds of property, and were thus taxed at a lower effective rate than all other types of property.

(2) The capital stock tax, an old but carefully neglected part of the revenue act essentially covering the assessment of the intangibles of domestic corporations, has been revised, even resurrected, since the 1931 assessment. Parallel with the re-establishment of the capital stock tax, an achievement for which credit must be divided between the Cook County Assessor and

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¹ Ill. Const., art. IX, §1.

² Ill. Rev. Stats. (1937) c. 120, §1.

³ Ely, *Taxation in American States and Cities* (1888) 293; Chapman, *Tax Commissions in United States* (1897); Proc. Nat. Tax Assn. (1910) 410; Seligman, *Essays in Taxation* 10th

ed., (1928) 62; Leland, *Classified Property Tax in United States* (1928) 12-19; Jensen, *Property Taxation in United States* (1931) 48-84.

⁴ See the convenient summaries in *Tax Systems of the World* (7th ed., 1937), published by the Commerce Clearing House.

⁵ The State government no longer levies any property taxes; it now relies upon sales, excise, and other taxes. If any property taxes were levied, however, they would necessarily be on the general property tax principle. This tax is the financial mainstay of the local governments.

the Illinois Tax Commission, has been the development of new methods of assessing the intangibles of foreign corporations. The capital stock tax is not applicable to foreign corporations.⁶ To prevent discrimination the method of taxing the intangibles of foreign corporations was designed to yield valuations equivalent to those found under the capital stock tax for domestic corporations.

(3) The assessment of corporately-owned intangibles was modified by a principle of allocation, i. e., the use of a formula to determine the situs and the proportion of the intangible property of all corporations subject to local taxation. This principle was held inapplicable to foreign corporations, however, in *Wheelock Lovejoy and Co. v. Gill*.⁷

Assessment of Intangibles Before 1931

The ineffective assessment of intangibles prior to 1931 is a matter of common knowledge. In 1929, for example, the assessed value of intangibles in Illinois was only one-fourth as great as the income from securities reported by individuals for federal income tax pur-

poses. Between 1921 and 1935 there was no year when assessed value of intangibles was as great as the taxable income reported.⁸

The situation in Chicago was the same as in the remainder of the State. The tax rates in Chicago furnish conclusive support on this point. Personal property, nominally (legally) assessed at its full cash value, was taxed at 4.85 per cent in 1927 and 6.74 per cent in 1930. Full value assessment at these rates would have confiscated the income from many investments and impinged upon the principal of others. Even an assessment of one-third of fair cash value (approximately the assessment ratio for real estate in 1926 and 1928, despite the legal requirement of a 100 per cent valuation) would have been equivalent to a tax of at least 25 per cent upon the income from these securities.⁹

The assessing authorities therefore developed a deliberate policy of non- or under-assessment while paying lip service to the general property tax.¹⁰ "Savings accounts were omitted . . . unless the taxpayer, in filing his return, put it [sic] in";¹¹ of course, the taxpayer

⁶ *Western Union Telegraph Co. v. Lieb*, 76 Ill. 172 (1875).

⁷ 366 Ill. 378, 9 N. E. (2d) 58 (1937).

⁸ Based upon a comparison of the assessed value of intangibles as published in the Annual Reports of the Illinois Tax Commission, and individual interest and investment income and dividends as published in the Treasury Department's Statistics of Income.

There is no satisfactory test of the comprehensiveness of the assessment of intangibles. Comparison of the assessed value of intangibles and the amount of income from intangibles reported for federal income tax purposes is probably as good a test as any other. (Cf. Maine Recess Committee on Taxation, Taxation in Maine (1934) 24-25; Leland, An Appraisal of Classification, Proc. Nat. Tax Assn. (1928) 292-318; Compton, Low Rate Taxes on Intangible Property, Third Preliminary Report to Ohio's

Taxation Committee (1930) esp. 31-46.

Cf. Jensen, Survey of Bank Taxation, a Report Prepared for the American Bankers Association (1931) 29: "It is probable that less than 5% of intangibles, other than bank stock, are assessed in practice."

⁹ If the assessment ratio were one-third, a security selling for \$100 would be assessed at \$33. At a rate of \$4.85 per \$100 of assessed valuation, the tax would be \$1.62; at a rate of \$6.74, the tax would be \$2.25. If the security were selling on a 6 per cent basis, these taxes would be 27 and 38 per cent, respectively, of income.

¹⁰ Summarized in Altman, Chicago's Experiment in Personal Property Taxation, 1931-1936 (1936) (dissertation, University of Chicago) 89-97.

¹¹ Abstract of Record, 76-77, *People v. Cesar*, 349 Ill. 372, 182 N. E. 448 (1932).

almost never did. The authorities granted an administrative exemption to bonds and tax warrants issued by Cook County and its local subdivisions. This exemption was so well recognized that bond and investment houses represented them to their customers as tax-exempt, and the Citizens' Committee, during its "rescue" campaign of 1930, urged Chicagoans "to buy these good 6 per cent tax exempt county . . . tax warrants"¹² to keep local governments afloat. Yet these securities are not exempted by statute, and they have been included on the tax rolls since 1931 without any statutory changes.

The payment of taxes on intangibles in the hands of individuals represented a voluntary contribution. There were no standards of listing or of valuing intangibles; each paid according to his conscience. The few individuals who made substantial contributions were exceptions. During the tax controversies of 1930 a list of individual assessments in the upper brackets was compiled, indicating that ninety-seven prominent Chicagoans, who were assessed for a total of \$168,354 for 1930, had paid \$7,202,769 of federal income taxes in 1925.

Intangibles owned by corporations were treated in a similar manner. Foreign corporations and unincorporated businesses were virtually exempt on their intangibles. Domestic corporations were legally assessable on their capital stock, which was essentially

their intangible property, yet no capital stock assessments appear on the Chicago assessment rolls for the period 1920-1925, inclusive. Between 1926 and 1930 capital stock assessments fluctuated between \$150,000 and \$173,000.¹³ Such variation indicates upon its face that there was no method of assessing capital stock. The writer's investigation indicates that the assessing officials met criticism of their capital stock assessments during some years by listing all the property of many large corporations as capital stock, without itemizing the various types of property, and without listing the different classes of tangibles under their appropriate columnar headings. The records of the Illinois Manufacturers' Association suggest the same chaotic state of affairs. Although the capital stock tax was enacted in 1872, one Chicago manufacturer complained to the general counsel of the Association in 1912 that "we, in common, we presume, with other Chicago and Illinois concerns, are being assessed on our capital stock; in fact, this is the first year we have ever been asked to pay anything on this head."¹⁴ Similar protests recurred from time to time. In 1919 another Chicago manufacturer, upon receiving his bill, protested, "We have never paid a capital stock tax and always understood that we were exempt,"¹⁵ and the same ignorance persisted as late as the 1930 assessment.¹⁶ But if the capital stock assessments determined by the Chi-

¹² Chicago Daily News, Jan. 22, 1930.

¹³ Illinois Tax Commission, Fifteenth Annual Report (1933) 217. For earlier commentaries, see U. S. Bureau of Corporations, *Taxation of Corporations* (1911) part III, 56, and *Special Report on Taxation* (1914) 71.

¹⁴ ¹⁵ Illinois Manufacturers' Association, Opin-

ions of General Counsel, No. 662. The Association has always been opposed to the capital stock tax. See, e. g., State Board of Equalization, Proc. (1873) 17; *ibid.* (1903) 13; letter to members April 1, 1930, discussing the capital stock tax.

¹⁵ Illinois Manufacturer's Association, *Opinions*, no. 1762 (1919).

¹⁶ *Id.* no. 3974 (1932).

chicago assessing officials were bad, the capital stock assessments of certain classes of corporations determined by the Illinois Tax Commission were little better.¹⁷ The Tax Commission appointed in 1933 made a survey of its predecessors' assessments and concluded that "the lack of records in the Tax Commission office and the inability of former employees satisfactorily to explain their procedures indicates . . . that capital stock assessments were made by no rule, by no methods and upon practically no facts in the vast majority of cases."¹⁸

During this period prior to the 1931 assessment, only corporate fiduciaries, in their character as executor, administrator, guardian, conservator, and trustee, were assessed in a partially systematic manner. The corporate fiduciaries were in an exposed public position and they could not escape taxation, yet they could not bear the full property taxes contemplated by law. Hence the assessing officials and the fiduciaries proceeded by destroying the illusion that intangibles could be taxed at the same effective rate as real estate and tangible personalty. Undervaluation certainly existed as far back as 1899. Corporate fiduciaries filed schedules listing their intangibles at agreed percentages of full value; the Board of Assessors and the Board of Review accepted their returns as filed,¹⁹ without

once in the period 1899-1930 making a thorough audit of their returns. The fiduciaries' standards of valuation were naturally extremely elastic. Some trust companies attempted to file fairly complete returns; others solicited new business on the basis of tax savings. It is characteristic of the situation that one individual who had served with the Board of Assessors from 1899 to 1930, first as an employee, later as chief clerk, and finally as an elected member, did not know on what basis the fiduciaries were supposed to file their returns.²⁰

Some system of undervaluing intangible property for purposes of taxation was necessary if the various important corporate fiduciaries were to be able to compete with each other, and with fiduciaries in New York, Boston, and other cities. The first methods of undervaluation were developed by bargaining between the assessing officials and the fiduciaries. The percentages of undervaluation used from 1899 to 1926 are not available, but they apparently varied with the size and the fiduciary nature of the trust or estate. These percentages were designed to produce desired effective tax rates. There was no stability in the percentages employed because the continual increase of property tax rates necessitated corresponding decreases of the percentages at which intangibles were

¹⁷ Twenty-six life insurance companies were subject to capital stock assessment for 1925 and 1926. Only three were assessed in 1925 and five in 1926. Valuations varied so widely that the Court concluded "that no uniform rule of assessment was followed." *Mississippi Valley Life Inc. Co. v. Storm*, 339 Ill. 245, 171 N. E. 134 (1930).

¹⁸ Fifteenth Annual Report (1933) 230 ff.

¹⁹ Since the Board of Assessors and the Board

of Review seldom had the same interests, one or the other claimed public attention by raising the valuations of a few of the larger trusts and estates. For the last few years preceding the 1931 assessment, the Board of Assessors generally made the increases, only to be reversed by the Board of Review.

²⁰ Abstract of Record, 301-2, *People v. Cesar*, 349 Ill. 372, 182 N. E. 448 (1932). Testimonies conflicted on percentages. *Id.* 237-38, 391-93.

returned. The percentages were not publicized and were not available to other property owners. They represented a working arrangement between the taxing bodies and the fiduciaries. Though they had no legal basis, their legality was never challenged.

The beginning of a more effective and comprehensive system of reporting trust and estate intangibles for taxation dates from 1924, when the larger trust companies in Chicago formed the Corporate Fiduciaries Association. Within two years, an elaborate system of undervaluation had been developed by the Association, the Board of Assessors, and the Board of Review. This system provided that property held by fiduciaries would be returned at varying percentages of full value. The percentages varied with the size and char-

acter of the trust: larger trusts were returned at a greater fraction of full value than smaller; estates in probate were returned at a greater fraction than testamentary or voluntary trusts. In 1927, when the tax rate was 4.85 per cent of assessed value, intangibles were reported at from 0.5 to 20 per cent of full value, equivalent to effective tax rates ranging from 0.24 to 9.7 mills.²¹

The methods of reporting intangibles were simplified in the following years, and the fractions employed for the larger trusts and estates were lowered as tax rates continued to increase. By 1930, when the tax rate had reached 6.74 per cent of assessed value, no intangibles were listed at more than 15 per cent of full value, and effective tax rates ranged from 1.3 to 10.1 mills.²²

The foregoing arrangements, though

²¹ As indicated in the following table:

TABLE I
ADMINISTRATIVE CLASSIFICATION USED BY CORPORATE
FIDUCIARIES IN CHICAGO, 1927*

Type of Holding	—Under \$100,000—		\$100,000 to \$500,000		— Over \$500,000 —	
	Frac- tion	Effective Rate	Frac- tion	Effective Rate	Frac- tion	Effective Rate
1. Administrative and Executive	10.0%	4.85m.	15.0%	7.28m.	20.0%	9.7m.
2. Guardian, Conservator and Testamentary Trusts	5.0	2.42	7.5	3.63	10.0	4.8
3. Voluntary trusts created by Illinois residents and by non-residents prior to April 1, 1926.....	1.0	0.48	1.5	0.73	2.0	0.97
4. Voluntary trusts created by non-residents after April 1, 1926.....	0.5	0.24	0.75	0.36	1.0	0.48

* Effective rate in mills based upon tax rate of 4.85% of assessed value.

²² Computed as follows:

TABLE II
ADMINISTRATIVE CLASSIFICATION USED BY CORPORATE
FIDUCIARIES IN 1930*

Type of Holding	— Under \$100,000 —		— Over \$100,000 —	
	Fraction	Effective Rate	Fraction	Effective Rate
1. Executor and Administrator.....	10.0%	6.7m.	15.0%	10.1m.
2. Guardian, Conservator and Testamentary Trusts	5.0	3.4	7.5	5.1
3. Voluntary Trusts	2.0	1.3	3.0	2.0

* Effective rate in mills based upon a tax rate of 6.74% of assessed value.

accepted by the assessing and reviewing bodies, were little more than gentlemen's agreements. Neither the Board of Assessors nor the Board of Review undertook to audit the returns filed by the fiduciaries. The smaller fiduciaries made little effort to follow this classification; individuals acting in a fiduciary capacity knew little or nothing about it; and even some of the larger fiduciaries substantially departed from the announced practices. In the course of an audit some 20 trust departments of smaller banks in Chicago, the writer found no uniformity in listing trusts or establishing valuations. One illustration will suffice: two trusts each having securities worth \$250,000, had been established for two sisters. An examination of the trust ledger accounts indicated that neither trust paid a personal property tax for the period 1926-1930. In 1928 a move was apparently made to pay a tax on one trust, for the account showed a debit labeled personal property tax. Eight days later, the matter had apparently been reconsidered, for the account showed a *credit* of the sum.

The situation in Chicago before the 1931 assessment, so far as it concerns intangible personal property, may thus be summarized very simply; intangibles were nominally taxed at the same rate as all other types of personal prop-

erty, but actually subjected to loose, ineffective, and discriminatory methods of assessment.

The property tax, particularly as applied to intangibles, has thus manifestly had no better success in Chicago and Illinois generally than in other states.²³ Yet all attempts by statute or constitutional amendment to modify the revenue system in any fundamental respect have failed.²⁴ These failures have led to the search for administrative regulations to fill the gap.

Administrative Classification of Intangibles

During the course of the 1931 assessment a comprehensive classification of intangibles for taxation was developed. Cash could openly be scheduled at 10 per cent of full value, and net credits, mortgages, stocks, bonds, and other intangibles at 20 per cent of full value.²⁵

This classification, it must be emphasized, differed fundamentally from the arrangements of undervaluation prevailing before that time. The classification of 1931 was general; it was stated in terms of specific classes of intangibles, regardless of the type of owners and the size of their holding. Classification was made public. All property owners were encouraged to schedule their intangibles on the "ten and twen-

²³ Among other accounts, see Illinois Bureau of Labor Statistics, Eighth Biennial Report: Taxation (1894); Haig, History of the General Property Tax in Illinois (1914); Altman, Chicago's Experiment in Personal Property Taxation, 1931-1936 (1936) (dissertation, University of Chicago) c. 1.

²⁴ Five classification amendments have been rejected since 1904; a new constitution liberalizing tax provisions was defeated in 1922; a proposal to call a constitutional convention was defeated in 1934. Illinois Legislative Reference Bureau, Constitution of Illinois (1934) 26-34;

Sears, Constitutional Revision in Illinois (1938) 33 Ill. L. Rev. 2.

²⁵ The only exceptions to the 20 per cent rule for securities were bonds and other obligations of Cook County and its subdivisions. Such securities were valued at 10 per cent of their market value. These had generally been sold as tax exempt, and the discrimination was a compromise. It was intended, however, eventually to treat locally-issued securities like all others, and they were so treated after the 1932 assessment.

ty" basis. For the first time, all owners of intangibles were required to report their intangibles at the same percentages of full value, and individuals, trustees, corporations, and unincorporated businesses were treated in the same manner. Equally important, all owners of intangibles knew or could easily learn what the classification percentages were. Finally, the undervaluation arrangements prevailing prior to the 1931 assessment, being the product of private negotiation each year, were elastic, *ad hoc*, and changeable. The classification of 1931 was intended to be permanent, general, and public, and it did retain these characteristics longer than any previous system of reporting intangibles, in large part because of intensive auditing of corporations, estate, trust, and individual schedules.

The classification for 1931 followed the general practice of those states having comprehensive classified property taxes. The "ten and twenty" recommendations were not arbitrary; on the contrary they were designed to equalize tax rates between Chicago and other areas which had adopted classification. On January 1, 1934, for example, seventeen states had differentially low taxes upon securities (mill taxes). The lowest rate in these states was 3.80 mills and the highest rate was 5 mills, i. e., 0.38 and 0.5 per cent of full value.²⁶ The effective mill rate in Chicago upon securities reported at 20 per cent naturally depended upon both the general assessment ratio and the general tax rate. At the time clas-

sification was adopted it was expected that the 1931 tax rate would be 7 per cent of assessed value; assessed value was, in turn, defined as 37 per cent of full value. The expected mill tax at the time of the adoption of classification was therefore 5.2 mills (7% of 37% of 20% of full value). In fact, the tax rate for 1931 was finally set at 7.35 per cent of assessed value, equivalent to a tax of 5.44 mills. The mill rate for 1932 was higher than that for 1931, and even the slight reductions in tax rates for 1933 and 1934 left the property taxes upon securities in Chicago among the highest, if not the highest, in the United States.

As a preliminary to further discussion of the effects of the 1931 classification, it may be interesting to note how Chicago adopted classification.²⁷ The reform of the assessment machinery in 1931 was followed by the appointment of a non-political assessor (probably the first in Chicago's history) in 1932, who had sincerely pledged himself to assess personal property, particularly intangibles. cursory investigation indicated the presence of long-continued but discriminatory undervaluations; it indicated too that intangibles could not be taxed at the same effective tax rate as all other property. The necessity for classification was clear. On the other hand, no public official was willing to adopt classification explicitly, and it was agreed that under the circumstances classification was illegal.

This problem was informally discussed at a select meeting at the Union

²⁶ Tax Systems of the World, op. cit. supra note 4.

²⁷ This discussion is based upon interviews with the principals concerned, and upon Ab-

stract of Record, 311-42, 431-32, 446-75, 502-6, 515-19, 543-44, 545-59, 561-62, 565-72, *People v. Commonwealth Edison Co.*, 367 Ill. 260, 11 N. E. (2d) 408 (1937).

League Club attended by several attorneys and civic leaders, a member of the Corporate Fiduciaries Association, a member of the State's Attorney's Office, and the County Assessor. The discussion proceeded to consider the constitutional requirement of uniformity. It appeared that while it was true that all property must be assessed in the same manner, it was equally true that any property owner was entitled to share in any widespread departure from uniform treatment of all classes of property.²⁸ It followed, as a corollary, that property owners had the right, even the duty, of listing their property for taxation in accordance with any widespread practices. Here were the grounds for the consensus that it might be possible to elaborate, define, or crystallize custom and usage in the form of a satisfactory method of assessing intangibles, on the basis of the concerted action of Chicago property owners, without official action by the assessing authorities. In other words, if a substantial body of property owners reported on a common basis, on the ground that this basis represented custom and usage, the assessing officials had good reason for accepting their returns unless they could prove that the property owners were not following custom and usage. It was ob-

vious that the legality of these practices would be strengthened the more widely they were known and practiced and the longer they were followed. There was agreement at the meeting that a competently written report might secure the desired practical method of assessing intangibles and still maintain an aspect of legality. It was necessary to secure only the desired report, a suitable sponsor, and publicity.

The sponsor with the required qualifications was the Joint Commission on Real Estate Valuation. Created in 1926 in connection with the discussion which later developed into the reassessment of real estate in 1928, it was legally a semi-official body composed of twenty-six public officials and citizens appointed by the President of the Board of Cook County Commissioners, yet it was virtually a citizen's committee since the public officials took little part in its proceedings. Its civic-minded chairman, George O. Fairweather, who was connected with the business administration of the University of Chicago, was willing and able to write the necessary report. Under his chairmanship the Commission had already published four reports dealing with both real and personal property assessments.²⁹

Starting from scratch, the chairman

²⁸ All property must be taxed uniformly in proportion to its value, and any deviations from fair cash value must be uniform. Systematic and intentional omission or undervaluation of certain types or classes of property is a necessary but not a sufficient condition of the invalidity of an assessment roll. If the omission or undervaluation is neither systematic nor unintentional, the Illinois courts always hold that the roll is valid, on the ground that lack of official zeal and competence cannot defeat tax collections. While the Illinois Legislature cannot discriminate in favor of personal property when the Constitution requires uniformity there

has been no case in Illinois where courts have invalidated all or part of an assessment roll which discriminated against certain classes of property or property owners. See the complete treatment of this subject in Illinois Constitutional Requirement of Uniformity in Taxation (1938) 33 Ill. L. Rev. 57.

²⁹ A study of Assessment Methods and Results (1927); A study of Assessment Organization and Legislation (1929); A Study of the Present Financial Difficulties of Local Governments and Their Causes (1929); and A Study of the Assessment and Taxation of Personal Property (1930).

conferred with the various individuals, organizations, and officials interested in the problem, and tabulated data on the mill rates in other states. Finally, in July, 1932, appeared his report, *Appraisal Standards for the Assessment of Personal Property*. The report did not recommend classification; it merely approved the listing of cash at 10 per cent and of securities at 20 per cent. It argued that such practice would result in a high effective tax rate, and yet would not drive intangibles away. No one was misled by this caution, however; indeed, at one point, the report refers to the "ten and twenty" rule as its "appraisal recommendations with respect to intangibles."³⁰ These recommendations were summarized in the daily press.³¹ Approximately 15,000 copies were distributed free by the Joint Commission through such organizations as the Association of Commerce, the Chicago Bar Association, the Illinois Manufacturers Association, and the Chicago Real Estate Board.

The County Assessor did not formally adopt the "ten and twenty" recommendations. He announced that his office was "not committed to this report by implication or otherwise," but he did admit, however, that the property owner had "the right to consider the custom and usage that prevails throughout the different counties of the State of listing personal property at less than its actual value," and accepted returns by taxpayers listing their property at "ten and twenty."³² Property owners who listed intangibles

at "ten and twenty" modified the oath on the personal property schedule to indicate that valuations were not at full value, but "in accordance with custom and usage in the State of Illinois," or "in accordance with Report V of the Joint Commission on Real Estate Valuation." The County Assessor accepted schedules and valuations sworn to in this manner. He did not reduce the valuations of intangibles scheduled at full value, but he did attempt to inform property owners of the existence and recommendations of the report.

This policy was perhaps excessively cautious. Statements that the County Assessor had not *officially adopted* the "ten and twenty" recommendations, but that he would *accept* schedules prepared on this basis, did not lend themselves to easy reconciliation. There were charges that this policy discriminated against the "little fellow," who was likely to be ill informed, in favor of the "big fellow," who was allegedly well served by his trade associations and representatives. The County Assessor undoubtedly was responsible for a policy which tended to create confusion, but he considered that confusion as the price of the legality of the total assessment roll. In any event, the charges of serious discrimination do not seem well founded. For every property owner who reported intangibles at more than "ten and twenty," there were at least several hundred (particularly the smaller property owners) who reported no intangibles. And the over-

³⁰ Op. cit., at 11.

³¹ Chicago Daily News, July 18, 1932; Chicago Tribune, July 19, 1932.

³² Cook County Assessor, Technical Order no.

2 (July 27, 1932) (mimeographed for public distribution); reprinted in Abstract of Record, 456, *People v. Commonwealth Edison Co.*, 367 Ill. 260, 11 N. E. (2d) 408 (1937).

assessed property owners could easily secure their deserved decreases at later stages of the assessment process.

The "ten and twenty" classification fulfilled such a definite need and attracted such powerful sponsors that it was not seriously attacked. Perhaps attacks were forestalled because the classification appeared to have welled up from below rather than to have been imposed from above. Thus the Illinois Tax Commission cautiously described the classification system and admitted that such an extra-legal arrangement stimulated the listing of intangibles and decreased the tax load upon all other types of property, but it warned that "whatever practices have been allowed to grow up with respect to the assessment of intangible property, the Tax Commission can only reiterate that such customs are extra-legal, and can be afforded no recognition."³³ The Commission made no attempt, however, to interfere with classification in Chicago.

Classification was not officially adopted by all assessment offices in Chicago until 1935, three years after it was first used, though the various offices concerned with the taxation process adopted it at different times. The Board of Appeals, during its hearings on the 1931 assessment, did not follow the cautious attitude of the County Assessor. It made revisions on the "ten

and twenty" basis, and it officially adopted this basis³⁴ in what was perhaps an incautious but certainly a politically expedient gesture. The chain of classification was extended when the State's Attorney announced in January, 1934, that no appeal would be taken in those cases where a trial court refused judgment on assessments of intangibles on a higher basis than 10 per cent for cash and 20 per cent for securities.³⁵ The trial courts had, in the meantime, adopted the procedure of computing assessments on intangibles at "ten and twenty." The County Assessor, however, still refused official recognition to classification. In 1934 he wrote that "there has emerged in Cook County and other counties of the State what may become well-established custom and usage in reporting cash, investments, and credits," but added that "until there is clear determination of the custom and usage, no official recognition can be given to the same."³⁶

The strength of the interests which demanded classification finally secured its official adoption from the County Assessor elected in November, 1934. Although the new Assessor had repeatedly announced during his campaign that he would assess intangibles at 100 per cent for 1934, he finally bowed to expediency and openly announced that he would use the 20 per cent factor.³⁷ A similar jockeying for

³³ Illinois Assessors' Manual (1933) 44, 45.

³⁴ See Chicago Tribune, Oct. 21, 1932. The Board of Appeals never issued any written statements of policy and procedure. For a typical statement of its "ten and twenty" attitude, see its letter in Chicago Evening American, May 25, 1933. But see Abstract of Record, 352-56, *People v. Commonwealth Edison Co.*, 367 Ill. 260, 11 N. E. (2d) 408 (1937).

³⁵ Proceedings for the Collection of Personal Property Taxes (Jan. 2, 1934) (mimeographed) 26.

³⁶ Cook County Assessor, Personal Property Assessment Manual (1934) 65.

³⁷ Chicago Tribune, March 14, 27, and 30, April 5, 6, and 9, 1935; Chicago Daily News, April 8 and 25, 1935. The writer assisted in the preparation of memoranda for the Assessor's

political advantage was evident during the 1935 assessment and with the same result³⁸

The measurement of the effects of classification presents difficulties. The faulty and changing³⁹ itemization of the various kinds of personal property on the assessment roll makes impossible a year-to-year comparison of the assessments of money, securities, and other intangibles. There are no data on the number of individuals who scheduled or were assessed for intangibles in various years, though it is clear that only a small number of individuals pay taxes on their intangibles.⁴⁰ The best, and indeed the only, data which illustrate the effects of the "ten and twenty" classification are those concerning the assessments of all estates and trusts in the central Chicago business district (South Town).

All trusts and estates in South Town were assessed \$19,000,000 for 1930; for 1931, the first year under the "ten and twenty" classification, assessments totaled \$40,400,000. Thus the assessment of the intangibles in estates and trusts more than doubled between the 1930 and the 1931 rolls, in the face of a decline of almost 6 per cent in bond prices

and of more than 37 per cent in stock prices.⁴¹ That assessments of estates and trusts for 1931-1935 were substantially higher than for the previous three years, 1928-1930, under the old system of undervaluation is evident from Table III. The reasons for these higher assessments in recent years are simple: more intangibles were reported, and the intangibles reported under the "ten and twenty" system were reported at higher fractions of full value than they were before classification was inaugurated. In Table III are listed the estimated percentages of full value reflected by the intangibles assessments for 1928 through 1938; these percentages are useful for comparison of the situation in various years, and should not be interpreted to reflect the absolute situation in any one year. They indicate that the intangibles in estates and trusts in the years immediately following 1931 were assessed at approximately 20 per cent of full value. For 1928-1930 these were returned at between 8 and 10 per cent of full value. In other words, the adoption of classification for 1931 has doubled the fraction of full value used in valuing intangibles for taxation, de-

Committee. The Assessor's version is found in Clark, *Assessment Administration in Illinois*, 8 *Municipal Finance* (1936).

³⁸ Chicago Herald and Examiner and Chicago Tribune, Oct. 17, 1935; Chicago Herald and Examiner, Jan. 12, 1936. The Assessor's statement of policy may be found in (editorial) Chicago Tribune, Sept. 24, 1937.

³⁹ The principal sources of information about the importance of the various classes of personal property are the itemizations (spreads) of the assessment rolls. It is a matter of common knowledge that the itemization, especially those prior to 1933, are almost valueless. Few property owners filed more than a lump sum valuation, estimates were never itemized, and in any case the different schedular classes

of property were contradictory and overlapping. In some years as much as 77 per cent of the total assessed value was classified as miscellaneous.

⁴⁰ Cook County Assessor (J. L. Jacobs), *Assessments of Real and Personal Property in Cook County, Illinois, 1931-1933* (1934) 89. A comparison recently made between the 1936 assessments in the township of Oak Park with the federal income tax returns for the same year indicated that the assessed value of intangibles (but cf. *supra* note 39) was \$743,000, but that it should have been \$6,399,000. The basis of calculation was not indicated. Chicago Tribune, Sept. 23, 1937.

⁴¹ Based upon the New York Times Index of 40 Bonds and the Standard Statistics Co. Index of 90 Stocks, as of April of each year.

spite the sharp increases in tax rates.

TABLE III⁴²
ESTIMATED PERCENTAGES OF FULL VALUE
USED IN ASSESSING INTANGIBLES,
1928-1938

Year	Assess- ments of Trusts and Estates ^a (millions)	Percentages Used in As- sessing In- tangibles ^b	Tax Rates ^c
1928	\$18.7	8	\$5.15
1929	21.9	10	6.15
1930	19.0	8	6.74
1931	40.4	19	7.35
1932	30.8	20	7.73
1933	28.3	18	6.49
1934	39.9	19	7.12
1935	40.8	19	8.37
1936	33.1	15	9.52
1937	35.0	16	8.73
1938	17.6	11	^d

^a Actual assessments of all trusts and estates in the Town of South, as of April 1st of each year.

^b The actual assessments for each year were deflated by the New York Times index of 40 Bonds (April quotations), using 1932 as a base. The result is a series of the estimated valuations that would have been realized if assessments had fluctuated in accordance with bond prices. Division of the series of actual assessments by estimated valuation shows the estimated percentage of full value represented by each year's assessment. But the 1932 assessment of intangibles was on the basis of 20% of full value; hence all the quotients were divided by five.

^c Per \$100 of assessed valuation. Assessed value since 1931 is 37% of full value (after classification). There was no formal or explicit equalization factor for personal property prior to 1931.

^d Not available.

The assessment of intangibles under classification produced more revenue

than it had produced under the *ad hoc* system of undervaluation. The tax records of two corporate fiduciaries indicate that they paid \$1,075,000 in personal property taxes for 1931 compared with \$590,000 for 1930. In part the greater productivity of their estates and trusts was the result of higher tax rates, but in larger part it was the result of higher assessments.

The percentages at which intangibles were classified were unchanged from the 1931 through the 1937 assessment. Dissatisfaction was voiced before and during the 1936 and 1937 assessments, however, that the classification percentages were too high in the light of mounting tax rates and decreasing interest yields. At the time the "ten and twenty" rule had been adopted for 1931 it was expected that the tax rate would be approximately \$7.00 per \$100 of assessed valuation. The tax rate for 1936 was in fact \$9.52. A \$100 bond reported at 20 per cent and taxed at this rate would pay 70 cents. Such a tax was equivalent to a flat income tax of 14 per cent if the bond yielded \$5.00 per year. Though there was no general change in the classification percentages for 1936, it has been reported that the corporate fiduciaries returned their intangibles at 15 per cent of market value for 1936, and again for 1937. The writer has been unable to verify this report. It is nevertheless clear that the assess-

⁴²These conclusions are based upon the calculations of Table III, note b. Several possible modifications might be mentioned. (1) Annual assessments might have been deflated by an index giving weight to changes in stock prices as well as bond prices. But there are no accurate data on the composition of trust assets. (Riddle, *Investment Policy of Trust Institutions* [1934] 152. The Annual Reports of the Comptroller of the Currency present tables

showing the composition of trust assets, but their results are distorted by arbitrary valuations.) Deflation with a bond index, starting from a depression, gives the most conservative results. (2) There should be some correction for the substantial increase in the number of trusts from year to year, but data are lacking. The calculations probably overstate the reporting percentages for the later years. Cf. the final results with the undervaluation percentages shown in Tables I and II, *supra*.

ments of all estates and trusts in South Town, which are principally against corporate fiduciaries, showed substantial reductions for 1936 and 1937. (See Table III.) These reductions could not have been the result of any decline in security prices. Though other factors may have been at work, the decreases for these years suggest that a lower basis of classification may have been employed.

The dissatisfaction with the heavy taxation of intangibles resulted in some relaxation of the percentages for 1937. The system of returning intangibles at 20 per cent was retained, but an alternative was provided, for securities could be returned at four times their annual income. The latter provision reduced the valuation basis for all securities yielding less than 5 per cent. But this basis was admittedly a makeshift, and a citizens' committee was appointed before the 1938 assessment to develop a new set of classification percentages in the light of prospective tax rates. Following the report of this committee, the Assessor announced that all intangible property was to be returned at 10 per cent of its market value, or at two times its annual income, whichever was the lower. For purposes of this classification no intangible was presumed to yield less than 2 per cent of its market value.⁴³ This method of classification yielded the following results: bank deposits and non-income yielding securities were returnable at 4 per cent of

their face or market value; securities yielding 3 per cent were returnable at 6 per cent of their market value; securities yielding 4 per cent, at 8 per cent of their market value; and securities yielding 5 or more per cent, at 10 per cent of their market value. Despite the high level of tax rates in prospect for 1938, these percentages have resulted in the lowest assessment, and will result in the lowest taxes upon intangibles since the introduction of classification for 1931.

The reduction for 1938 has emphasized in striking fashion the strength of administrative classification in Chicago. The change for 1938 was extra-legislative, the committee's recommendations were public, the Assessor's regulations were made applicable to all property owners and were made generally available, and the assessment for 1938 went forward on the lower basis without any question of law or procedure being raised.⁴⁴

Capital Stock Taxation

The capital stock tax is a modification of the general property tax. It is a tax upon corporations based upon the value of corporate property not otherwise specifically or fully itemized or assessed, including intangible property, going concern value, and the under-valuation of tangible property.⁴⁵ Whatever its particular form, the tax is essentially a catch-all for under-assessed real estate tangible personal property, a substitute for the separate assess-

⁴³ Assessment Order no. 25, June 28, 1938, reported in CCH. Ill. CT. '20-311 and pp. 2933-35.

⁴⁴ Chicago Tribune, June 29 and 30, 1938; Chicago Daily News, June 29, 1938.

⁴⁵ Cf. the definition by Hodes, *The Illinois Capital Stock Tax* (1933) 28 Ill. L. Rev. 332n:

"'Corporate excess' may be defined roughly to mean the excess of the value of a corporation's total assets, over the value of its tangible property." But corporate excess assessments are not based upon the deduction of the value of tangible property, but of its assessed value.

ment of the various kinds of intangible property (cash, net credits, etc.), and a means of reaching good will or going concern value. In general, the adoption of a capital stock or corporate excess tax has always signified dissatisfaction with the general property tax as a means of taxing corporations.⁴⁶ The assessable value of capital stock is defined as the difference between the unit value of the corporation and the total assessed value of its real and personal property separately listed on the tax rolls. But the development of rules for the determination of this unit value, and hence of the corporate excess, has never been based upon a defensible or a consistent theory of property valuation.⁴⁷

The capital stock of manufacturing, mercantile, printing, newspaper publishing, coal mining, and stock breeding corporations is assessable locally—in Chicago, by the County Assessor—while the capital stock of all other corporations is assessable by the Illinois Tax Commission.⁴⁸ There is no authority for the assessment of the capital stock of foreign corporations, and these

are assessable in the same manner as individuals.⁴⁹ The provision of the Revenue Act establishing the capital stock tax nowhere defines the tax base. Instead, it authorizes the Tax Commission to adopt rules for determining the value of capital stock and to make these binding upon the local assessors.⁵⁰ In accordance with this power, the Tax Commission (and its predecessor, the State Board of Equalization) has prescribed Rule Eleven for the assessment of capital stock, to govern its own assessments as well as those of local assessors throughout the State. Rule Eleven defines the value of a corporation as the aggregate of the value of its outstanding shares plus the debt (both long and short term) incurred for other than current purposes. Capital stock is computed by subtracting the assessed value of all tangible property listed separately from the assessed value of the corporation as a whole.⁵¹

The formal aspects of Rule Eleven have been upheld by the courts, and there is no question that the procedures there outlined would produce de-

⁴⁶ Seligman, *op. cit.* supra note 3, at cc. 6-8; Corbin, *Taxation of Mercantile and Manufacturing Corporations*, Proc. Nat. Tax Assn. (1909) 313-14; California Tax Commission, Final Report (1909) 265-68; Friedman, *Taxation of Corporations in Massachusetts* (1907) 163-74; Hunter, *Development of Corporation Taxation in New York* (1917) 1-21; Moore, *Taxation of Corporations in Illinois* (1913) 5-12.

⁴⁷ Cf., for example, Massachusetts Commission on Taxation (1875) 122-24; Massachusetts Commission on Taxation (1897) 69; *Commonwealth v. Hamilton Mfg. Co.*, 94 Mass. 298, 302-3 (1866); U. S. Bureau of Corporations, *Taxation of Corporations* (1909) part I, 17-18; 58 L. R. A. (1901) 577. The unit value of the corporation has been, at one time or another in various states, determined as follows: (1) the par value of the shares of stock; (2) book value of the shares of stock (when New York used this method, the value of capital stock was the

par value of the shares plus surplus in excess of 10 per cent of such par value); (3) market value of the shares; (4) market value of the shares plus bonded debt; (5) market value of shares plus bonded and floating debt; (6) as a unit without the announcement of a method of computation.

⁴⁸ Ill. Laws, 1879, p. 251; Ill. Laws, 1893, p. 124; Ill. Laws, 1905, pp. 353-54, declared unconstitutional in *Consolidated Coal Co. v. Miller*, 236 Ill. 149, 86 N. E. 205 (1908).

⁴⁹ *Western Union Telegraph Co. v. Lieb*, 76 Ill. 172 (1875).

⁵⁰ Ill. Rev. Stats. (1937) c. 120, §3(4); cf. §5340 (10), 339 (3, 6).

⁵¹ The text of Rule Eleven may be found in each of the Annual Reports of the State Board of Equalization (1872-1919) and of the Illinois Tax Commission (1920 to date). The revised form of Rule 11 as of Oct. 14, 1938, may be found in CCH, Ill. CT, 123-891 to 23-980.

fensible legal assessments.⁵² On the other hand, there is no question that the Rule was applied inefficiently, indifferently, and sometimes scarcely at all. The assessments under this rule determined by the State Board of Equalization from 1872 to 1919, and by its successor, the Illinois Tax Commission, from 1919 to 1933 have been condemned time and again by their members, official investigating committees, the courts, and private citizens.⁵³ A convenient summary of the state of affairs was furnished by the Chairman of the Tax Commission in connection with a capital stock assessment for 1920. The Oak Ridge Cemetery Corporation had a paid-up capital of \$445,100 represented by 44,510 outstanding shares of stock with an admitted value of \$44,510; it had long term debts totaling \$262,000; its deductible tangible property was valued at \$1,200. The Chairman described the process of assessment in these words: "We take your capital at \$40,000 and your debt at \$260,000 and we depreciated that to \$100,000 and equalized that on the basis of sixty per cent, producing \$60,000, and we deduct the full value of your tangibles, \$1,200, which leaves \$58,800. We made further depreciation of \$8,800, and took it at \$50,000, and assessed at

\$25,000."⁵⁴ A study conducted by the Tax Commission appointed in 1933 indicated that in 1921 there were no capital stock assessments in 85 of the 102 counties in Illinois, and that the best record in the period 1920-1933 was made in 1932, when only 19 counties had no capital stock assessments.⁵⁵ It is therefore clear that, when the Cook County Assessor started to assess capital stock in earnest in Chicago for 1931, there was no clearly defined procedure of assessment. Although the formal statement of Rule Eleven was well known, although Rule Eleven had been approved by the courts, no definite rule or set of rules had been followed in assessing capital stock locally or centrally.

The County Assessor's problem was further complicated by differences in assessment jurisdiction and states of incorporation. Corporation assessments fell into three groups: 1) domestic corporations subject to capital stock assessment by the local assessors, including manufacturing, mercantile, printing, newspaper publishing, coal mining, and stock breeding corporations (13,300 or 57.1% of the total in 1934); 2) all other domestic corporations, subject to capital stock assessment by the Illinois Tax Commission

⁵² *Porter v. R. R. I. and St. L. R. R. Co.*, 76 Ill. 561 (1875); concurrent proceedings in 13 Fed. Cases 574 (1875), *rev'd* in *State Railroad Tax Cases*, 92 U. S. 575 (1875).

⁵³ For example: *official reports*: Report of Revenue Commission of Illinois (1886) ii, v-vi; Illinois Bureau of Labor Statistics, Report (1894) 317-41; Fairlie, A Report on the Revenue System of Illinois (1910) 84-96; Illinois Tax Commission Report (1933) 228-41; *courts*: the group of Teachers' Federation cases, *Chicago Union Traction Co. v. State Board of Equalization*, 112 Fed. 607 (1901); *State Board of Equalization v. Goggin*, 191 Ill. 528, 61 N. E. 339 (1901); *Chicago Union Traction Co. v. State*

Board of Equalization, 114 Fed. 557 (1902); and *Raymond v. Chicago Union Traction Co.*, 207 U. S. 20 (1907); all discussed in Altman, *op. cit.* supra note 10, at 15-18; *Calumet and Chicago Canal and Dock Co. v. O'Connell*, 265 Ill. 106, 106 N. E. 452 (1914); *Peoples Gas Light and Coke Co. v. Stuckart*, 286 Ill. 164, 121 N. E. 629 (1919); *Oak Ridge Cemetery Corp. v. Tax Commission*, 299 Ill. 430, 132 N. E. 553 (1921); *Mississippi Valley Life Ins. Co. v. Storm*, 339 Ill. 245, 171 N. E. 134 (1930).

⁵⁴ *Oak Ridge Cemetery Corporation v. Tax Commission*, 299 Ill. 430, 433, 132 N. E. 553 (1921).

⁵⁵ Report (1933) 217.

(6,700 or 28.7% of the total in 1934); and 3) all foreign corporations, subject to assessment by the local assessors, not on their capital stock, but on their intangibles (3,300 or 14.2% of the total in 1934).⁵⁶ There seemed to be little possibility, when the County Assessor began his 1931 assessment,⁵⁷ of a uniform assessment of the capital stock of domestic corporations, because of the dual jurisdiction involved. As a first step, he therefore tried to achieve uniformity between foreign corporations and those domestic corporations subject to his jurisdiction.

The assessment rules adopted by the County Assessor for 1931 reflected two principles: 1) each kind of property shall be assessed uniformly, regardless of its owner; and 2) where corporations are concerned, the state of incorporation shall not affect the amount of the assessment. The rules adopted equalized assessments among foreign corporations, domestic corporations locally assessed, individuals, trusts, and estates. Foreign corporations were assessed on those intangibles which had a tax situs in Cook County,⁵⁸ these intangibles were itemized on the assessment roll as cash, securities, mortgages, etc. Domestic corporations were assessed on the same property and for the same valuation, but the assessment of intangibles was lumped and entered on the tax roll as capital stock. This method of assessing capital stock valued the intangibles of domestic corporations di-

rectly, rather than *via* their liabilities as contemplated by Rule Eleven; it also stipulated an equivalence between domestic and foreign corporations which was nowhere required by statute.⁵⁹ Capital stock and the various kinds of intangibles (except cash) were returned at twenty per cent of full value. These rules were later adopted by the Board of Appeals, so that assessments and revisions of corporation assessments for 1931 and 1932 were made on the same basis.

Although, as indicated below, these rules did not reach all the corporate excess, they had certain advantages over more complicated rules giving theoretically more complete results. They were simple and easily administered. They made it possible for corporations to compute their own capital stock or intangibles assessments for the first time. They could be handled more easily than the formal Rule Eleven, and they could be applied with less information. The value of such important intangibles as cash, accounts receivable, and investments can be accurately determined from a corporation's balance sheet and supporting statements. On the other hand, annual earnings data are indispensable for determining the value of a corporation's stock, a prerequisite to the application of Rule Eleven. The value of capital stock strictly computed from Rule Eleven would include the values of the intangibles mentioned and, in years of

⁵⁶ Illinois Tax Commission, Annual Report (1934), 97.

⁵⁷ It must be remembered that the reassessment of 1928 had delayed assessments in Chicago. All the other local assessors in the state and the Tax Commission had completed their 1931 assessments before the County Assessor

began his assessment for that year in the summer of 1932. For one expensive consequence of this, see *People v. Commonwealth Edison Co.*, 367 Ill. 260, 11 N. E. (2d) 408 (1937).

⁵⁸ See the discussion of allocation, *infra*.

⁵⁹ This equivalence has long been regarded as necessary. Hodes, *supra* note 45, at 354-55.

high earnings, the values of good will, patents, copyrights, and the like. In years of low earnings, however, the assessment under Rule Eleven would be less than the corresponding assessment computed by valuing cash, receivables, and investments separately, and by neglecting good will, patents, etc. These differences in the theory of capital stock assessment were accentuated by reasons of expediency.

The Illinois Manufacturers' Association advised its members that they were not obliged to furnish even balance sheets,⁶⁰ and explained that balance sheets "would be misleading if included" in a personal property tax return.⁶¹ The County Assessor had no authority to compel the presentation of balance sheets or earnings data,⁶² and corporations were unused to furnish such data. It therefore seemed clear, at the beginning of the 1931 assessment, that no corporation would furnish more than a balance sheet, if indeed they would furnish so much, and that the simpler method was preferable.

The Illinois Tax Commission appointed in 1933 began its capital stock assessment for 1933 while the County Assessor was finishing his assessment for 1932. The new Commission decided, as the County Assessor had decided a year and a half earlier, to assess capital stock strictly. To this end it revised the antiquated personal property schedule, simplified the property itemization, and added supporting schedules for stock and bond quota-

tions, net income, and officers' salaries. The Commission decided to adopt the corporate excess principle enunciated in Rule Eleven but never enforced, and to compute the unit value of each corporation subject to its jurisdiction. One essential element in this computation was capitalized adjusted net profit. To net profit, as defined for federal income tax purposes, was added interest accrued or paid on bonds and other indebtedness not incurred for current purposes; average adjusted net profit for the preceding five years was computed by weighting each of the three most distant years by one, the fourth year by two, and the fifth or most recent year by three; average adjusted net profits were then capitalized at 6 per cent for railroads, 21 per cent for personal service corporations, and 7 per cent for all other corporations. Capitalized net profit was averaged with the market value of capital and indebtedness, provided the stocks and bonds were listed on security exchanges, or with the book value of capital and indebtedness. From the unit value of the corporation was then deducted the assessed value of the real estate and tangible property assessed locally.⁶³

The decisive actions of the Assessor and the Tax Commission strictly to assess capital stock accentuated the differences in their methods. One fundamental difference should be noted. The Tax Commission's method, based upon a valuation of liabilities and net worth, was an application of the pure corporate excess principle; the County As-

⁶⁰ Letter to members, Jan. 15, 1932; Opinions of General Counsel, no. 3938, Jan. 30, 1932.

⁶¹ *Id.* Jan. 13, 1932.

⁶² Attorney General of Illinois, Opinions (1934),

June 4, 1934. The Illinois Tax Commission has more power to compel the presentation of information than the local assessors.

⁶³ Assessors' Manual (1935) 153-66.

essor's method, based upon a valuation of individual assets, was simply an extension of the general property tax principle of assessing separately all the different kinds of intangible property. The corporate excess method yields more fluctuating assessments than the simple property tax methods; in periods of high earnings it yields higher, and in periods of low earnings, lower assessments than the latter.

Conferences between the Tax Commission and the County Assessor were held to eliminate these differences. The County Assessor was at first unwilling to abandon a method which was simple, effective within its limits, and generally understood;⁶⁴ the Tax Commission desired to achieve state-wide uniformity of capital stock assessment, and knew that adoption of its method in Chicago would be a most important argument for adoption by other local assessors.

The County Assessor finally modified the rules used in 1931 and 1932. Cash, securities, and net credits were to be assessed as before. His modified rule provided for the assessment of an additional item called franchises, patents, copyrights, good will, and/or trade rights of every descrip-

tion. These were items of property reached by the Tax Commission's corporate excess method and not reached by a separate valuation of intangibles. To reach this group of items the County Assessor capitalized at 16⅔% average earnings for the preceding five years in excess of 7% upon the corporation's net worth (after deduction of the book value of patents, etc.)⁶⁵

The County Assessor's modified rule approached that of the Tax Commission, but differed from the latter in three significant respects. First, under the Assessor's rule, the capital stock assessment of a domestic corporation could never be less than the value of its cash (at 10 per cent) and of its securities and other intangibles (at 20 per cent). Secondly, under the Assessor's rule, the capital stock assessment could never be as high as under the Commission's. The Commission capitalized net earnings at 7 per cent (except for personal service corporations), the Assessor used 7 per cent as a normal return upon capital, but capitalized above-the-average earnings at 16⅔ per cent.⁶⁶ It is doubtful whether the differences between the classes of corporations assessed by the two offices justi-

⁶⁴ Another important reason for retention of the status quo was the impending general county election. The County Assessor had no support in either political machine and was not a nominee for any office. On the other hand, one member of the Board of Appeals was a candidate for reelection and the other was a candidate for President of the Board of Cook County Commissioners. The assessing and reviewing offices had had a long history as instruments for the collection of campaign funds, the rewarding of friends, and the punishment of enemies. Maintenance of existing rules minimized the possibility of pre-election favoritism by the Board of Appeals. If a well-known rule did not prevent "adjustments," it at least focused attention upon them. The adoption of a new rule, especially if it de-

pended upon the analysis of complex data and yielded variable results, favored the prospects of manipulation.

⁶⁵ Assessment Manual (1934) 61-2.

⁶⁶ The United States Board of Tax Appeals has been faced by a similar problem in determining the value of corporation property, usually in connection with gains on such property acquired, exchanged, or merged. The Board has usually allowed a basic rate of return on tangible property; remaining income, if any, is capitalized at a higher rate to determine the value of intangible property. Its average rate of return in thirteen cases, the last, *Shanley and Furness, Inc.*, 21 B. T. A. 146 (1930), has been 9 per cent on tangibles and 18.6 per cent for excess income.

fied such differences in capitalization factors. Thirdly, under the Assessor's rule, assessments would be equalized between domestic and foreign corporations. The state of incorporation affected merely the name under which property was assessed, but not the amount of the assessment.

Various changes have been made in the methods of assessing capital stock since the 1933 assessment. These revisions have brought the Tax Commission and the County Assessor closer together.⁶⁷ The Assessor has adopted the Commission's procedure of determining a unit value for the corporation and then subtracting the assessed value of real estate and tangible personalty. The Commission has adopted the procedure of allocating away from Illinois, where necessary, part of the capital stock of domestic corporations.⁶⁸ Both offices employ a combination of two of the following three methods to determine the unit value of a corporation: (1) the market value of the outstanding shares of stock, bonds, and other indebtedness for other than current purposes; (2) the capitalized weighted average net earnings for the preceding five years; and (3) the fair value of all the corporation's assets (equal to book value after suitable adjustments) minus indebtedness for current purposes. Where factor (1) is available, both offices determine the unit value as the average of factors (1) and (2); where factor (1) is unavailable, the unit value is equal to the average of factors (2) and

(3). In computing the unit value of the corporation, both offices deduct the value of all securities exempt from state and local taxation,⁶⁹ shares of stock of domestic corporations, and shares of stock of national banks. There are, however, three outstanding differences in the application of these methods. First, the offices differ in the percentages used to capitalize average net income. The Tax Commission capitalizes the net income of personal service corporations at 21 per cent, and of all other corporations except railroads at 7 per cent; the County Assessor capitalizes net income at 5 per cent. Secondly, they differ in the methods used to determine the portion of a corporation's capital stock which has a taxable situs outside the State. The Commission has recommended that capital stock be allocated away on the basis of a fraction equal to the book value of tangibles situated outside the State divided by the book value of all tangibles. The County Assessor deducts intangible values only when it can be shown that they have an affirmative situs outside the State. Thirdly, the offices differ in their attitude toward classification. The Tax Commission neither accepts nor computes valuations based upon the classification of intangibles; the County Assessor classifies the full value of capital stock for tax purposes at 10 per cent. (Prior to the 1938 assessment the Assessor classified capital stock at 20 per cent.) Tax Commission assessments should therefore be substan-

⁶⁷ A summary of the present sets of rules may most conveniently be found in CCH, Ill. CT. ¶20-318, with the Commission's rules reproduced on pp. 2654-2655-3, and the Assessor's rules on p. 2675. See the Commission's Illinois Assessor's Manual (1938) ch. IX.

⁶⁸ See the discussion of allocation, *infra*.

⁶⁹ The County Assessor adopted this procedure for the 1938 assessment after *Price Flavoring Co. v. Lindheimer*, 368 Ill. 450, 14 N. E. (2d) 397 (1938).

tially higher, for similar corporations, than those determined by the County Assessor. Curiously enough, none of the corporations assessed by the Commission has seriously raised the question of discriminatory treatment. The explanation may be, in part, that many Tax Commission assessments, when litigated in Cook County, have been reduced in the lower courts to the 20 per cent basis formerly used by the County Assessor.⁷⁰

Allocation

The assessment of the intangibles of domestic and foreign corporations is complicated by the interstate character of business enterprise. Knotty questions of equity, evasion, and double taxation are presented by the property taxation of interstate business, particularly when complicated by competition, different state corporation charters, movement of property, varying tax dates, and dissimilar tax systems. These questions have been condensed into discussions of the meaning of situs or jurisdiction to tax.

The problem of situs is inherent in the general property tax, and arises whenever business transcends political boundaries. It arose early in connection with the taxation of the capital stock and the railway cars of the railroad, car equipment, and express companies. Railway cars have no definite location, yet they are clearly not en-

titled to exemption everywhere. Demands for local revenue led to the adoption of a concept of situs which made such property locally taxable, a concept which defined or created a situs by allocation.⁷¹ The determination of situs through allocation and averaging has been extended from railway cars to interstate bus and truck companies with little difficulty. Its extension to air lines presents interesting problems in Chicago.⁷²

The situs of intangibles constitutes the most treacherous of all allocation problems. In a relatively simple situation, an order might be received by the Chicago office, shipment made from the factory in Indiana, credit extension approved by the head office in New York, billing done from Chicago, and the customer's remittance, mailed in the first instance to Chicago, might be immediately transferred to New York. How much, if any, of the account receivable on the books of the Chicago office are taxable in Chicago? If the company's securities are kept in New York, income received there, and changes in portfolio there determined, is any part of these security holdings taxable in Chicago? Similarly, if the company has an ascertainable good will, is any part of that taxable in Chicago?

Harding summarized the judicial solution of these problems with the concept of integration.⁷³ But his summary

⁷⁰ For a general discussion of the role of the courts, see Altman, *The Role of the Courts in Personal Property Tax Cases in Chicago* (1937) 32 Ill. L. Rev. 171.

⁷¹ *American Refrigerating Co. v. Hall*, 174 U. S. 70 (1898); *People v. Wilson Car Lines*, 369 Ill. 294, 16 N. E. (2d) 752 (1938).

⁷² For several years the airlines were assessed on the estimated average number of planes on the ground. It is not suggested, how-

ever, that allocation under the property tax is the best practicable method of taxing airlines. Cf. Thompson, *State and Local Taxation Affecting Air Transportation* (1933) 4 J. Air Law 479 at 484-85; Opinion of Attorney General of Mississippi, June 7, 1933, reported in 5 *ibid.* 158 (1934); Opinion of Attorney General of California, no. 10870, August 3, 1936, reported in 8 *ibid.* 142 (1937).

⁷³ Harding, *Double Taxation of Property and*

has the same faults as the cases themselves: it does not suggest what practical criteria are readily applicable by administrative bodies to yield substantial justice in individual cases. Shall situs represent an attempt to tie specific intangibles to a particular state, or shall it be an overall allocation based upon formula?

All of the problems concerning the situs of intangibles in Chicago were handled by considering each corporation as a unit, and by defining both the situs and the amount of intangible personal property subject to taxation by an administrative formula based upon measurable business elements. The allocation formula used was a variation of the Massachusetts rule,⁷⁴ and was finally stated as follows:⁷⁵

1. Obtain the total of gross business done, wages and salaries paid, and tangible property owned.

2. Obtain gross business done in Cook County, wages and salaries paid to employees in Cook County, and tangible property in Cook County.

3. Allocate to Cook County all intangible property owned by the company in the ratio of the Cook County to the entire company total.

For the 1931 and 1932 assessments, allocation was applied to the cash, credits, and securities of foreign corporations, and to their equivalent, the capital stock of domestic corporations.

After 1933 allocation was extended to good will, i. e., capitalized excess earnings.

The application of statutory allocation formulas to the capital stock of corporations owning property in several states has long been upheld. In upholding such a group of state taxes in 1897 the United States Supreme Court remarked that "no fine-spun theories about situs should interfere to enable these large corporations, whose business is carried on through many states, to escape from bearing in each state such burden of taxation as a fair distribution of the actual value of their property among those states requires."⁷⁶ State income taxes are equally dependent upon statutory or administrative rules of allocation.⁷⁷ Of the twenty-nine states which had a corporation tax based upon net income as of October 1, 1936, eighteen had statutory, and eight had administrative allocation formulas.⁷⁸

The use of an allocation formula in Chicago differs from the situations mentioned because the revenue act does not mention allocation. The revenue act authorizes the taxation of the capital stock of domestic corporations, of all real and tangible personal property located within the State, and of all intangible property "used, held, owned or controlled by persons residing in this State."⁷⁹ The revenue act

Income (1932) 42. Cf. Seligman, *op. cit.* *supra* note 3, at 13; Blackett, Memorandum on Double Taxation, A Report to the Provisional Economic and Financial Committee of the League of Nations (1921); Report on Double Taxation Submitted to the Financial Committee of the League of Nations (1923) 22-45; Leland, Harding on Double Taxation (1936) 24 Calif. L. Rev. 379; 2 Cooley, Taxation §§465-68.

⁷⁴ Mass. Laws, 1919, §§30, 32, 37-42.

⁷⁵ Cook County Assessor, Technical Order no.

48 (April 8, 1933); reproduced in Personal Property Assessment Manual (1934) 65-66.

⁷⁶ Adams Express Co. v. Ohio State Auditor, 166 U. S. 185 (1897).

⁷⁷ This question is thoroughly discussed in Ford, Allocation of Corporate Income for the Purpose of State Taxation, Spec. Rept. no. 6 of the New York State Tax Commission (1933).

⁷⁸ Tax Systems of the World, *op. cit.* *supra* note 4, 128-33.

⁷⁹ Ill. Rev. Stat. (1937) c. 120, §1(2).

thus apparently provides for neither (1) the allocation of the capital stock of domestic corporations *away* from Illinois where domestic corporations own property and do business in other states,⁸⁰ nor (2) the allocation to Illinois of a portion of the intangibles of foreign corporations similarly situated.⁸¹ So far as domestic corporations are concerned, no allocation is necessary, even though double taxation results.⁸²

The use of an allocation formula in Chicago, while not prescribed by statute, was an attempt to achieve a rough justice in the taxation of intangibles. The same allocation formula was applied to both domestic and foreign corporations. Allocation was used to remove from the local tax roll some of the intangibles of domestic and foreign corporations subject to taxation elsewhere, and to add to the tax roll some of the intangibles of foreign corporations. This procedure was created by the Cook County Assessor for all corporations subject to his jurisdiction, but it is interesting to note that allocation of the capital stock of domestic corporations *away* from Illinois was subsequently adopted by the Illinois Tax Commission.⁸³

The use of an allocation formula was not contested in the courts for several years. In part, the objectivity of the rule made it acceptable; in part, the Board of Appeals and the lower courts strategically departed from it in cer-

tain cases;⁸⁴ in part, the low assessments of good will based upon depression valuations and incomes made the additional tax burdens negligible. In 1937, however, the taxation of the Chicago branch of a Massachusetts corporation on an (estimated) allocated portion of its net credits and good will was declared illegal in *Wheelock Lovejoy and Co. v. Gill*.⁸⁵ It does not appear from the record that the corporation furnished all the data on business done, tangible property owned, and wages paid required by the allocation formula, though it was stipulated that 16 per cent of the corporation's total sales were made in Illinois. After the corporation failed to schedule any cash, credits, or good will for 1934, the Assessor added to the valuations scheduled for machinery, equipment, and merchandise, estimated values of \$10,000 for net credits and \$10,000 for good will. The Board of Appeals upheld these two items, but the Illinois Supreme Court invalidated them. The Court asked whether the revenue laws authorized the taxation of a portion of the net credits and other intangibles of a foreign corporation, and answered that they did not.⁸⁶ In reaching this decision, the Court emphatically approved the common-law doctrine that the situs of personal property follows the domicile of the owner, and then approved the business situs doctrine—stressing the two well-defined cases of a revolving fund invested and rein-

⁸⁰ Except railroads (Ill. Laws, 1937, H. B. 468).

⁸¹ *Wheelock Lovejoy and Co. v. Gill*, 366 Ill. 378, 9 N. E. (2d) 58 (1937).

⁸² *Cream of Wheat Co. v. Grand Forks County*, 253 U. S. 325 (1920); cf. *Schuylkill Trust Co. v. Pa.*, 302 U. S. 506 (1938).

⁸³ Illinois Assessors' Manual (1935) 163-65, and

Manual (1938) 188-91.

⁸⁴ One attorney once remarked to the writer, "I have no intention of making my corporations fight test cases so long as I can get relief at the Board of Appeals or in the circuit court."

⁸⁵ 366 Ill. 378, 9 N. E. (2d) 58 (1937).

⁸⁶ *Id.* at 378, 384.

vested locally, and of shares of stock localized outside the state of incorporation for business purposes.⁸⁷ It is perhaps arguable that the Court would have approved the allocation of corporate net credits and good will without express statutory authorization if a pertinent precedent had been found. No precedent was offered, and the Court was indisposed to break new ground. The Court's decision was stated in general terms, with no reservations on the score that many stronger cases could have been presented. It was stipulated, for example, that 16 per cent of the corporation's sales were made in Illinois, yet the Court did not consider the possibility that some foreign corporation might have 75 per cent of its sales, property, and payroll in Illinois. What the Court may find in a stronger case is conjectural. The writer believes that, failing specific statutory authorization, allocation would not be upheld: first, because the doctrine of *Wheelock Lovejoy and Co. v. Gill* is now *stare decisis*; secondly, because a bill introduced into the Illinois Legislature after the decision creating a statutory allocation formula based upon two factors, the value of tangible property and business done, failed to pass;⁸⁸ thirdly, because the Tax Commission's bill of 1937 covering the assessment of railroads specifically provides for allocation of the intangibles of both domestic and foreign corporations, without however specifying a rigid formula;⁸⁹ and fourth-

ly, because the Court has never shown any particular sympathy with administrative necessities in tax matters.⁹⁰

Whatever the course of future decisions may be, the damage will already have been done. The decision has discriminated between those foreign corporations which paid taxes upon their allocated intangibles and those which did not. The decision has weakened efforts to tax the intangibles of foreign corporations and may eventually lead to the abandonment of such efforts. It is one thing to grant that the Assessor has the power to tax all those intangibles which have an affirmative business situs in Chicago. It is quite another matter to expect corporations foolishly to have their intangibles in Chicago on the tax date, or to imagine that the Assessor can easily prove that such intangibles as were left have an affirmative business situs. Taxing the intangibles of large interstate corporations without allocation resembles running the Normandie with an outboard motor.

Evaluation of Results

Except for the principle of allocation, the administrative regulations discussed have been subjected to very little litigation; their *de facto* existence has gone unchallenged. It is somewhat difficult to appraise their revenue raising possibilities. Their introduction for the 1931 assessment coincided with a period of progressive, able administration that marked a sharp break with

⁸⁷ Id. at 381-82, 384.

⁸⁸ H. B. 586, introduced into the 60th General Assembly.

⁸⁹ Laws, 1937, H. B. 486.

⁹⁰ For example, the Tax Levy Pre-Adjudica-

tion Law (Ill. Laws, 1937, H. B. no. 734) was declared unconstitutional in *Griffin v. Cook County*, 16 N. E. (2d) 906 (1938). The law was greatly needed (see Altman, *supra* n. 70) and had been secured after great trouble and financial losses.

the past. In appraising the revenue raising possibilities of the administrative regulations, we must remember that they were accompanied by the reorganization of the assessment machinery, the installation of qualified personnel, the collection of essential data, the adoption of definite written standards of value and rules of procedure, and as a result of all these changes, a great improvement in public confidence in the assessment offices. Hence simple comparisons of revenue raised cannot be attributed solely to any one method, rule, or valuation procedure. If this qualification is kept in mind, a few side lights upon the changes wrought by the administration regulations can be made.

The introduction of the "ten and twenty" rule removed the specter of confiscatory taxation and thus made possible the listing of intangibles. This rule, coupled with a small increase in tax rates, almost doubled the actual tax payments on intangibles owned by trusts and estates between 1930 and 1931. These results achieved by an administrative regulation may be compared with those secured in other states through the adoption of constitutional or statutory classification. Measured in terms of increased revenues secured from intangibles, administrative classification in Chicago was more successful in increasing revenue than statutory classification anywhere else in the United States. In Kentucky and Minnesota, where classification brought better than average results,

classification increased assessments, but in Kentucky, at least, it decreased revenues.⁹¹ In Chicago, on the other hand, administrative classification increased both assessments and revenues. The immediate and substantial increase in revenue from intangibles in Chicago is thrown into greater relief by Leland's conclusion, based upon a nationwide study of classification, that "the revenues produced by classification have not always exceeded the revenues produced by the general property tax, and . . . the increases in revenues over those produced by the general property tax have seldom been immediately realized."⁹²

An appraisal of the improvements in corporate taxation is more difficult. Corporation assessments after 1931 were probably, on the whole, higher than in 1929 and 1930, despite the decline in prices. But any conclusive measurement of this increase is complicated by the more or less flagrant padding in the rolls prior to 1931. Two examples of the pitfalls of comparison may suffice. The Edgewater Beach Hotel was listed at \$850,500 for 1930, a valuation almost twice as great as the combined assessments of the seven largest hotels in Chicago. The tax bill of the Edgewater was later reduced by the circuit court from \$58,514 to \$4,582.⁹³ An even more striking case was the \$16,651,000 assessment for 1930 of a small company called Davies Industries, Inc. A field investigation reduced this valuation to \$17,344 for 1931.⁹⁴ This one decrease offset 40 per cent of

⁹¹ Leland, *Classified Property Tax in the United States* (1928) 262, 274.

⁹² *Op. cit.* supra note 8, at 317-18. Cf. other papers on the same subject, *id.* 240-92.

⁹³ See the assessment and tax rolls for Lake View, district 4.

⁹⁴ See the assessment and tax rolls for Lake, district 1.

the increase on 33 public utilities. Perhaps the safest conclusion with respect to corporation intangibles is that prior to 1931 few corporately-owned intangibles were assessed, and those of foreign corporations were assessed even more inadequately than those of domestic corporations.

The principle of allocation, now declared inapplicable to foreign corporations, was an integral part of the program for making assessments according to well defined rules. It gave intangibles a tax situs in Chicago, it helped mitigate double taxation, and it secured equal treatment of domestic and foreign corporations. Its invalidation by the Illinois Supreme Court should not obscure the facts that such doctrines as business situs, integration, and *mobilia personam sequuntur* are incapable of meeting the problems of the taxation of corporately-owned intangibles. The history of the assessments of brokerage and stock exchange companies in

Chicago may be suggestive. Prior to the 1931 assessment they were assessed only on their tangible property; their intangibles were not assessed, partly because there were no definite rules for valuing intangibles (a circumstance which did not, however, prevent the assessment of banks, trusts, and estates), and partly because their intangibles presented the essence of the problem of situs. The adoption of a principle of allocation resulted in an increase of the total assessment of the 55 largest investment companies and brokerage houses from \$767,195 in 1930 to \$8,836,000 in 1931. The record of the taxes paid by these companies indicates that many of these assessments were paid in full. These results suggest too that, since the courts demand a statutory base for allocation, a general authorization or a specific formula should be provided by the next session of the Legislature.

